Supreme Court, U. S.
FILED
JUN 6 1975
MICHAEL RODAK, JR., CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1974

NO. 74-687

UNITED STATES OF AMERICA,
Petitioner

v.

THOMAS W. MOORE, JR., Assignee for Benefit of Creditors of Emsco Screen Pipe Company of Texas, Inc., *Respondent*

On Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

BRIEF FOR THE RESPONDENT

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BRIEF FOR THE RESPONDENT

PRELIMINARY STATEMENT

The Petitioner's brief has accurately related the opinions below, jurisdictional grounds, the statutes involved, and the question presented. An additional relevant statute is Tex. Rev. Civ. Stat., Art. 7269, which establishes a priority for the payment of state and city taxes, and which reads in relevant part as follows:

> "In all cases where a taxpayer makes an assignment of his property for the payment of his debts, or where his property is levied upon by creditors, by writs of attachment or otherwise, or where the estate of a decedent is or becomes insolvent, and the taxes assessed against such personal property, or against any of his estate remain unpaid in part or in whole, the amount of such unpaid taxes shall be a first lien upon all such property. . . ."

In brief, this case involves the Government's claim of absolute priority to the proceeds of the insolvency of Emsco Screen Pipe Company of Texas, Inc. ("Emsco"). The Assignee for Benefit of Creditors contends that the federal priority statute does not apply to the federal claims in the instant case because claims unliquidated at the time of insolvency are not "debts due" within the contemplation of the statute.

Reference is made to the stipulations of the parties and exhibits attached to such stipulations. (A. 32-42) In June, 1966, Emsco entered into contracts with various military agencies. Emsco defaulted, and the agencies terminated such contracts. On October 20, 1966, Emsco made a voluntary Assignment for Benefit of Creditors to the Defendant-Respondent, Thomas W. Moore, Jr., who continues to be the voluntary Assignee for the benefit of Emsco's creditors. While two of the claims were already terminated for default prior to such Assignment, the Army claim was not terminated until December 6, 1966. The United States had not liquidated its damages on any of the contracts prior to October 20, 1966, the date of the assignment for benefit of creditors. (A. 33-34)

The contingent, unliquidated nature of the claims of the United States can be seen best from the opinion of the Armed Services Board of Contract Appeals in regard

to the Navy claim. (A. 43) Through the Assignee, Emsco contended that there should be no excess costs because of the Government delay in authorizing progress payments and the precarious financial position of Emsco at the time of its bids. (A. 45) There was testimony that, immediately after the bid, Emsco requested progress payments, but through an oversight on the part of a governmental employee, the Government contracting officer ignored the request for approximately two and one-half (2½) months. (A. 47) Other testimony showed that the contracting officer erred in his required finding that Emsco had adequate financial resources to perform the contract, which under some circumstances could excuse performance by Emsco. (A. 61) The court held that these arguments did not excuse Emsco from excess costs because the errors of the contracting officer were made in good faith and were caused to some degree by Emsco. (A. 51-52; 61) Although the Court ruled against Emsco, the opinion shows that there were bonafide disputes, and accordingly, the damages on the Navy contract were highly contingent and unliquidated as of the time of the Assignment for Benefit of Creditors.

In addition to the amounts owing to the Government, Emsco owes approximately $7,000.00 to the City of Houston on a tax lien (A. 41) and $68,759.00 to 61 private creditors (A. 68-69). Assets available for distribution total $55,707.28. If the Federal priority statute applies, creditors other than the United States will receive nothing on their claims. If the Federal priority statute does not apply, after payment of the priority tax lien in favor of the City of Houston, the private creditors will receive approximately 30% on their claims and the United States will receive approximately 40% on its claims.

SUMMARY OF ARGUMENT

This case involves the interpretation of the term *debts due* within the insolvency-priority statute, 31 U.S.C. § 191, which reads in relevant part as follows: "Whenever any person indebted to the United States is insolvent . . . the debts due to the United States shall be first satisfied". This statute has been carried forward substantially unchanged in wording since its passage in 1797. Two Supreme Court cases have dealt with the matter indirectly, but appear to be inconsistent. One of the Supreme Court cases suggests that an unliquidated claim is not included in the term *debts due. Massachusetts v. United States,* 333 U.S. 611 (1948). The other Supreme Court case did not address itself to whether an unliquidated claim falls within the confines of *debts due* and the issue apparently was not before the court. *King v. United States,* 379 U.S. 329 (1964).

The Assignee contends that federal priority is so harsh on other creditors that it should be accorded only in those situations in which the statute clearly applies, such as in taxes, bonds, and other liquidated debts. Following the reasoning in *Massachusetts v. United States, supra,* one must look to the common law action of "debt" in giving substantive content to the term "debts due". At the time the statute was written, unliquidated claims were not considered "debts."

Priority does not apply in the instant case because the Governmental claims were unliquidated and unascertainable as of the time of the insolvency and accordingly were not "debts due" at that time. In the instant case, instead of a priority distribution to the United States, which would take all available funds, the United States should share with other creditors on a pro rata basis after payment of taxes.

ARGUMENT

THE UNITED STATES IS ENTITLED ONLY TO ITS PRO RATA SHARE OF THE DISTRIBUTABLE ASSETS BECAUSE ITS CLAIMS WERE NEITHER LIQUIDATED NOR ASCERTAINABLE AT THE TIME OF THE ASSIGNMENT FOR THE BENEFIT OF CREDITORS.

A. Judicial Precedent Indicates That Unliquidated Claims Were Not Contemplated In The Term "Debts Due" In The Federal Priority Statutes.

In *Massachusetts v. United States,* 331 U.S. 611 (1948), an assignee for the benefit of creditors paid state unemployment taxes rather than Federal insurance contribution taxes. The state argued that the assignee was entitled to do so because of provisions in the Federal law allowing credit for monies paid to approve state unemployment funds. The Court held that the right to pay the state taxes and take credit for them was cut off by the insolvency, which gave rise to the priority statute. It reasoned that the priority of the United States was absolute and was not conditional, once insolvency had arisen. The Court reasoned further that applying credits to the Federal tax for the state tax, as urged by the Commonwealth of Massachusetts, would take the priority statute beyond the term "debts due to the United States" because it would establish a contingency at the time of the insolvency. The language on which the Assignee relies in this case is as follows:

> "A further effect might be to make the statute applicable beyond the scope of the term 'debts due to the United States'. For if the taxpayer's subsequent election can destroy the priority retroactively, not

> only the priority but the 'debt' itself becomes contingent. *And it is at least doubtful on the statute's wording that obligations wholly contingent for ultimate maturity and obligation upon the happening of events after insolvency can be said to fall within the reach of 'debts due' as of the time of insolvency.*" (emphasis added) 68 S.Ct. at 756.

It is clear that the priority statute is detrimental to other creditors of the debtor. In the instant case, for example, 62 other creditors of Emsco will receive nothing on their claims if priority applies. Because of the harshness on other creditors, priority should only be accorded in the instances in which the statute clearly applies, such as in taxes and other liquidated debts.

The Assignee asserts that the term "debts due" does not include contingent, unliquidated damages. Numerous authorities indicate that the term "debt" in a legal sense, refers to a liquidated claim or a sum certain. See 26 C.J.S. "Debt", Page 5 and 6. As pointed out in the court below, a common law action of "debt" pertained to a liquidated or certain sum. *United States v. Moore,* 497 F.2d 976, 978 (5th Cir. 1974) *citing* Stephen, Principles of Pleading, 8th Am. Ed. p. 13 (1859). *Massachusetts* itself pointed out in a footnote that in the long history of the statute that all the decisions sustaining the priority were for debts clearly due and owing and that Congress *"drew the line for its operation close to, if not at, the commonly accepted meaning of 'debt' as distinguished from other forms of obligation."* 68 S.Ct. at 756. A leading case interpreting the statute held that taxes were within the term "debts due". *Price v. United States,* 269 U.S. 492, 46 S.Ct. 180, 181 (1926). In its opinion, the Court gave strong support to the contention that "debts" mean liquidated claims by stating that "an action of *debt* lies to

recover taxes where *the amount due is certain or readily may be made certain."* 46 S.Ct. at 181. See also *Legett v. Southeastern Peoples College,* 68 S.E.2d 263, 267 (North Carolina, 1951) in which the court stated that "a debt due is a debt accrued, and a debt is accrued when all events have occurred which fix and determine the liability of the debtor to the creditor." In the instant case, the claims of the United States were unliquidated as of the time of the insolvency, and accordingly were not present debts within the contemplation of the statute.

Of course, Respondent does not argue that all the stringent requirements of the common law action of debt be applied. Respondent argues only that the term "debts due" must be interpreted in light of those common law actions in giving substantive content to such term. Since the term "debt" contemplated a sum certain or readily made certain in the common law action, it is reasonable to assume that a liquidated obligation was contemplated by the framers of the legislation.

The Government has attempted to create the impression that any judicial distinction between "debt" and "claim" is anachronistic. To the contrary, the distinction is still used in other statutes. For example, in determining whether interest was deductible in a tax case, the Fifth Circuit stated:

> "[W]henever it is uncertain whether anything will ever be demandable by virtue of the contract, it cannot be called a 'debt'. While the sum of money may be payable upon a contingency, yet it becomes a debt only when the contingency has happened, the term 'debt' being opposed to 'liability' when used in the sense of an inchoate or contingent debt." *United States v. Virgin,* 230 F.2d 880, 882 (5th Cir. 1956).

See also Tomlinson v. 1661 Corp., 377 F.2d 291, 295 (5th Cir. 1967).

Perhaps the most authoritative interpretation of the term "debts due" in the priority statute is found in an 1832 case by this Court in which the Court held that a bond in favor of the United States was a "debt" within the statute even though the maturity of the bond was after the insolvency. *United States v. The State Bank of North Carolina*, 6 Pet. 29 (1832). In the opinion, Justice Story indicated that the term was used in a common law sense and was to be interpreted in the sense of the common law maxim: *debitum in praesenti, solvendum in futuro.* 6 Pet. at 39. Translated, the phrase means a present debt, payable in the future.

In the common law usage, the phrase refers to an ascertained sum of money that was certainly and in all events payable at some time in the future. Examples of this type of obligation would be promissory notes and bonds. The type of obligation would be a sum certain or readily made certain by mathematical computation. The common law usage of the term did not include obligations wholly contingent for ultimate maturity and obligation upon the happening of later events, as opposed to the mere passage of time. *See Baltimore City v. Rice*, 50 Md. 302, 316 (Md., 1879); *People v. Arguello*, 37 Cal. 524, 525 (Cal. 1969); *Bank of Pennsylvania v. Wise*, 3 Watts 394, 401-403 (Pa., 1834); *Wood v. Partridge*, 11 Mass. 488, 493 (Mass., 1814); *Davis et al. v. Samuel Ham et al.*, 3 Mass. 33, 37 (Mass., 1807); *Wentworth v. Whittemore*, 1 Mass. 471, 472-473 (Mass., 1805).

For example, in one of the foregoing authorites, the court held that the potential wages of a sailor were not

subject to attachment in accordance with the statutory terms, because they were not really "debts" until the ship had landed, which was a later event, a contingency. *Wentworth v. Whittemore*, 1 Mass. 471, 472-473 (Mass., 1805). In the instant case, at the time of the Assignment for Benefit of Creditors, the damages owed by Emsco to the United States were wholly contingent for ultimate maturity upon the happening of later events and not the mere passage of time. There had to be a repurchase and re-letting of the contracts to liquidate damages. As of the date of the insolvency, it was possible there would be no damages or that Emsco would be excused from performance. One could not ascertain the prospective obligation by mathematical calculation, as in the case of a promissory note or a bond. There was no "debt" to which the United States was entitled to prior payment to the detriment of other creditors.

The majority and concurring opinions of the Court of Appeals properly looked to the common law for guidance in interpreting the term "debts due". Both opinions correctly focused on the question whether the amount of the obligation was certain or readily ascertainable at the time of insolvency. To that extent, the Court of Appeals decision is consistent with the interpretation of the term "debts due" by the Supreme Court in *Massachusetts* and *State Bank*. Certain language in the majority opinion below is perhaps too broad if interpreted to require that the obligation be presently payable at the time of insolvency; but that unfortunate language should not detract from the court's proper insistence that a "debt" within the statute must be a liquidated claim, in the sense of a certain sum or a sum readily ascertainable by mathematical computation. The addition of the "mathematical computation"

requirement allows the inclusion of debts payable after insolvency, such as promissory notes, bonds, etc. within the common law maxim, *debitum in praesenti, solvendum in futuro,* in accordance with the *State Bank* decision.

From the foregoing authorities, it seems clear that the term "debts due", as used in the priority statutes and as interpreted by Justice Story in the *State Bank* decision, was used in the common law sense of liquidated damages. Had the legislature intended to include torts, unliquidated damages, or other types of obligations, it would have used broader language such as "claims". It is a fair assumption that broader words were not used because of the harsh affect on other creditors of the insolvent.

B. Contrary Precedent Has Failed To Analyze Whether The Term "Debts Due" Includes Unliquidated Claims.

The Government relies on various cases that urge a liberal construction of the priority statutes, in order to protect the Government's purse, particularly in bankruptcy cases. The Court should not, however, go beyond the plain meaning of the words "debts due" as intended by Congress. As indicated in the *State Bank* case, the statute ought to receive a fair and reasonable interpretation, in accordance with the just import of its terms. 6 Pet. at 33. The meaning of the term "debt", and the early cases heretofore cited, indicate that the framers of the legislation probably intended the term "debts due" as some type of liquidated, present debt. *Massachusetts v. United States, supra,* 68 S.Ct. at 756; *The United States v. The State Bank of North Carolina,* 6 Pet. 29, 39 (1832).

In a separate concurring opinion below, Judge Coleman reasoned that Congress has considered the term "debt" adequate to the consummation of its fundamental purpose: to protect the Government's revenue. "It has been content to rely on *debts;* it has not seen fit to expand the language to include '*claims*' or such like." *United States v. Moore,* 497 F.2d 976, 979 (5th Cir. 1974) (emphasis added).

The argument of protecting the Government's purse has its strongest application in connection with tax revenues, which was one of the original purposes of the Act. *Price v. United States, supra,* 46 S.Ct. at 181. Taxes are "debts due" because they are reasonably liquidated claims; the amount due is certain or readily may be made certain. *Id.,* 46 S.Ct. at 181. The alleged events giving rise to the tax may be disputed; but, if they have occurred, the tax is ascertainable as of the particular time in question. Liquidation does not depend on events subsequent to the time in question, as in the instant case. Tax revenues are a revenue source that can be reasonably anticipated in the federal budget. In the instant case, the United States is not actually out any money because of the failure of Emsco because the contracts were relet at proper bids. It is doubtful that the fiscal policy of the United States depends to any substantial degree on damages gleaned from business failures of companies lacking business acumen. While it is true that government claims on contract defaults may be affected by the instant case, the more significant Government tax claims should be relatively unaffected.

The Respondent acknowledges that there are cases in which the court has assumed that priority applied to unliquidated claims. Such cases are of dubious precedential

value because of the lack of any reasoning, discussion, or authority. In many of the cases cited by the Government, it is unclear whether the court is even talking about priority or about unliquidated claims. For example, in the case of *United States v. Brunner,* 282 F.2d 535 (10th Cir., 1960), the matter before the court was whether the government's claim for breach of contract was a provable claim for purposes of set-off in bankruptcy. Contrary to the Government's assertions in its brief, the court said nothing about the matter of priority.

Of the authorities cited by the government, the case closest on its facts is *King v. United States,* 379 U.S. 329 (1964). There, this Court held the estate of a distributing agent liable for unliquidated breach of contract claims the United States had against the insolvent. The Court assumed that priority applied, and the matter whether claims unliquidated at the time of insolvency were entitled to priority was apparently not briefed. As in the other cases relied on by the Government, that issue simply was not before the Court. Such cases as *King* should not be binding on the instant case because of the failure of the attorneys to analyze and argue the question whether priority applied.

C. In The Instant Case, Fairness To All Creditors Requires Pro Rata Distribution.

In the instant case, the assets available for distribution total $55,708.28. If the United States is awarded a priority on those funds, other creditors, including suppliers of Emsco, will receive nothing on their claims. If the Supreme Court orders distribution on a pro rata basis

after payment of the approximate $7,000.00 tax lien in favor of the city of Houston, trade creditors will receive approximately thirty per cent (30%) on their claims and the United States will receive approximately a forty per cent (40%) recovery on its total claims. Because of the harshness on other creditors, priority should only be applied in those particular instances in which the priority statute clearly applies, such as in taxes, bonds, and other liquidated debts. Such a result is fair when one considers the significant adverse impact of the priority statutes on suppliers and other creditors of the insolvent, many of whom perhaps extended credit on the strength of the government contract. After all, such creditors had no opportunity to anticipate the extent of the possible governmental claims because of the unliquidated nature of such claims.

Much in the Government's brief concerns the applicability of the priority statutes in bankruptcy cases. The priority statutes operate to give a 5th class priority to the United States in matters of bankruptcy under the terms of 11 U.S.C. § 104(a). For purposes of determining priority, there would be no difference in an assignment for benefit of creditors and in a bankruptcy action. The first consideration has to be whether the priority statute applies. Thus, the same considerations of fairness to all creditors in the evaluation and recognition of unliquidated claims would be present in a bankruptcy case as in the instant case. Contrary to the rhetoric in the Government brief, the Assignee does not contend that the priority test in bankruptcy is different from that in other types of insolvencies. Rather, the Assignee contends that the determination is the same in all situations described by the

priority statute and depends on whether the amount of the obligation was ascertainable at the time of the insolvency.

It is important to distinguish between *recognition* of the Government's claims and *priority* of such claims. Certainly the Government's claims should be recognized in the instant case, though they were unliquidated at the time of the insolvency. There are implications in the Government's brief that the Assignee is attempting to cut off the Government's claim. To the contrary, the Assignee seeks to distribute the assets on a pro rata basis to all creditors, including the United States, after payment of the tax lien in favor of the city of Houston.

Even wholly contingent claims are recognizable in bankruptcy. 11 U.S.C. §103 (a) (8) (9). But to say a claim is recognizable does not mean it necessarily should be entitled to a priority over other similarly recognizable claims. In *State Bank, supra,* Justice Story argued by analogy to decedents' estates that unmatured *debts* were entitled to priority because such *debts* were recognizable in the probate of estates. 6 Pet. at 37. The Government has sought to extend that analogy by the citation of cases dealing with the recognition of unliquidated *claims.* The Government neglected the remaining portion of *State Bank* where Justice Story stated that the term "debts due" was to be understood by reference to the common law maxim, *debitum in Praesenti, solvendum in futuro,* which has been analyzed in the foregoing portions of this brief to indicate a definite, ascertained sum, payable in the future.

CONCLUSION

For the foregoing reasons and in the interest of fairness, the judgment of the Court of Appeals for the Fifth Circuit should be affirmed, and the case should be returned to the trial court with instructions to enter judgment for the United States for its pro rata share of the distributable assets after payment of the tax lien in favor of the city of Houston.

Respectfully submitted,

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June 1975

CERTIFICATE OF SERVICE

Service was posted on opposing counsel by certified mail this 5th day of June, 1975.

THOMAS OSA HARRIS